

DEFENSE CONTRACT AUDIT AGENCY

AUDIT PROGRAM FOR EXAMINING AND REPORTING ON CONTRACTOR BILLING SYSTEM AND RELATED INTERNAL CONTROLS

Contractor's Name: _____

Assignment Number: _____

Field Audit Office: _____

Date Assigned: _____

Auditor Assigned: _____

Supervisor's Signature Indicating
Approval (Obtain Signature Before
Starting Audit)

A. PURPOSE AND SCOPE

The major objectives of this audit are to:

- Obtain a sufficient understanding of the contractor's Billing System and related internal control (including both manual and computerized activities) to plan related contract audit effort. This requires that the auditor assess the adequacy of the contractor's policies and procedures, whether they have been implemented, and if they are working effectively.
- Document the understanding of the Billing System internal control in working papers and permanent files.
- Test the operational effectiveness of Billing System internal controls.
- Assess control risk as a basis to identify factors relevant to the design of substantive tests.
- Report on the understanding of the Billing System internal controls and assessment of control risk and the adequacy of the system for government contracts.

This audit program is limited to the examination of the Billing System and related internal controls for major contractors, nonmajor contractors where the system is considered significant, and other contractors with substantial negotiated firm-fixed price contracts. Only those controls directly related to the contractor's Billing System, as defined below, will be audited under this assignment. Controls for interrelated audit concerns regarding the adequacy of the contractor's other major systems (i.e., Budget and Planning, Estimating, etc.) will be audited under separate assignments. While the controls for these areas are not part of this audit, the results of all audits of these interrelated controls must be considered in forming an overall audit conclusion on the Billing System internal control . The results of this audit should be commented on in reports of related audit areas.

When performing an update or follow-up examination, the audit steps below should be adjusted and tailored accordingly. To the extent possible, prior audit effort should be used as a basis for validating the contractor's internal control.

Before beginning this audit, the auditor should be alert for internal control evaluations performed by the contractor or its external auditor relating to this audit area. In those cases where internal evaluations have been performed, the auditor should follow the guidance contained in CAM 4-1000, Relying Upon the Work of Others.

Before performing any examination of internal controls, the auditor should determine that the system contemplated for examination is material to the Government. Once it is determined that the system is material to the Government, the auditor should reassess the materiality of each section in the internal control audit program before performing any audit steps in that section. The scope of any audit depends on individual circumstances. The auditor is expected to exercise professional judgment, considering vulnerability and materiality, in deciding the scope of audit to be performed.

The use of computers of all kinds in a contractor's accounting and management systems is so pervasive it is unlikely any audit of them could be performed adequately without an examination of the internal controls over their automated aspects. Therefore, the auditor should become familiar with guidance contained in the Information Systems (IS) Auditing Knowledge Base that is found on DCAA's Intranet, prior to the initiation of this audit. In addition in some instances, the assistance of IT specialists may be required to adequately evaluate the automated aspects of the internal controls. In these cases, auditors should contact their regional offices to obtain the necessary expertise.

The internal control matrix (see Attachment 1) shows the interrelationships among the control objectives, control activities, and audit procedures used in this audit program. The control objectives and the audit procedures have been fully integrated into this audit program; therefore, the matrix is not needed unless it is desirable to see the associated control activities and the interrelationships in a matrix format.

<u>Staff Hours</u>		<u>Auditor's</u>	
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B. PRELIMINARY AUDIT EFFORT

1. Research and Planning

- a. Become familiar with applicable sections of CAM 5-1100 and any recent Headquarters guidance not incorporated in the CAM.
- b. Consider the extent and results of the contractor's self-governance activities, internal and external audits, coordinated audits, etc., related to the Billing System. In those cases where internal or external audits have been performed, the auditor should follow the guidance contained in CAM 4-1000, Relying Upon the Work of Others. Document your evaluation.
- c. Review the permanent file for:
 - (1) Existence of contractor billing policies and procedures.
 - (2) Organization charts depicting the functional areas responsible for the processing of billing related data.
 - (3) Billing system flowcharts, providing a pictorial overview of all manual and computerized processing steps.
 - (4) Information systems documentation:
 - (a) Pertinent record layouts of files created and/or used during the processing of billing related transactions.
 - (b) Database table definitions.
 - (c) Source documents.
 - (d) Information on the conversion of documents to computer media.
 - (e) Subsidiary or master files affected by the system.

(f) Relevant reports, journals, and ledgers produced in the flow of information to the billing reports.

- (5) Employee awareness training programs.
- (6) Listings of current government contracts.
- (7) Previous system audits performed. Check if system is applicable and if applicable, determine if it is relevant to the current system audit:

SYSTEM	Applicable?	Relevant?
Accounting		
Billing		
Budget (Planning)		
Compensation		
EDP		
Estimating		
Indirect/ODC		
Labor		
Material		
Purchasing		

- (8) Audit lead sheets.
 - (9) The analysis of the control environment and the results of any other audits, for internal control weaknesses that may impact this examination.
- d. Discuss the planned evaluation of the Billing System internal controls with the administrative contracting officer and the contractors' major procurement activities to identify, understand, and document any concerns they may have of areas which should be evaluated. The auditor should reassure the ACO and procurement activities that DCAA Billing System audits can satisfy customer requirements and eliminate the need for submittal of excessive contractor documentation with

interim vouchers. In addition, determine if the ACO wants us to perform specific audit services to support the ACO's responsibilities under FAR 32.503-5 or other guidance.

- e. In planning and performing the examination, review the fraud risk indicators specific to the audit. The principal sources for the applicable fraud risk indicators are :

- Handbook on Fraud Indicators for Contract Auditors, Section II.4. (IGDH 7600.3, APO March 31, 1993) located at www.dodig.osd.mil/PUBS/index.html, and
- CAM Figure 4-7-3.

Document in working paper B any identified fraud risk indicators and your response/actions to the identified risks (either individually, or in combination). This should be done at the planning stage of the audit as well as during the audit if risk indicators are disclosed. If no risk indicators are identified, document this in working paper B.

2. Entrance Conference and Preparation

- a. Prepare a written memorandum to the contractor to arrange for an entrance conference, covering the areas highlighted in CAM 4-302 and any specific data or pertinent information not yet provided.
- b. Conduct an entrance conference as outlined in CAM 4-302, with particular emphasis on:
 - (1) Requesting the contractor to provide, if applicable (see step E.4.), a demonstration of the Billing System

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transaction flow including data input, data processing, data output, and related internal controls.

- (2) Any changes in the billing processing job stream since the last audit.
- (3) The contractor's monitoring process to ensure that established manual and computerized controls are functioning as intended.
- (4) Any identified weaknesses which may have been reported and related follow-up actions taken.
- (5) Requesting the contractor to identify any contracts with requirements to submit excessive documentation with vouchers such as: travel/ODC reports, labor detail, time cards, or receipts for travel/ODC.

3. Other Preliminary Steps

- a. Determine the billing process employed by the contractor and to what degree a computerized system is used.
- b. Perform a high level cursory assessment to determine if the following exist:
 - (1) A functional organization with defined organizational responsibilities.
 - (2) A written description of the work flow in the billing process.
 - (3) Policies and procedures for effectively controlling the process.

4. Initial Risk Assessment

Using the information obtained in steps 1, 2, and 3, prepare an initial risk assessment to determine the scope of the examination (W/P B).

C. CONTROL ENVIRONMENT

The control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure. The auditor should obtain sufficient understanding of the control environment to determine the impact that it might have on the overall effectiveness of the Billing System internal controls.

1. Obtain a copy of the most recently completed ICAPS for the Control Environment and Overall Accounting Controls. Review the rationale behind any moderate or high risk assessment ratings and determine the potential impact, if any, on the effectiveness of the billing system internal controls.
2. If an examination of the control environment has not been recently performed, review all documented prior audit experience with the contractor, including permanent files, relevant audit reports and working papers, suspected irregular conduct (SIC) referrals and discussions with prior auditors. Obtain an understanding of the following factors:
 - a. Integrity and ethical values.
 - b. Commitment to competence.
 - c. Board of directors and/or audit committee participation.
 - d. Management's philosophy and operating style.
 - e. Organizational structure.
 - f. Assignment of authority and responsibility.
 - g. Human resource policies and procedures.
3. Document the overall assessment of the control environment and the impact that it has on the examination of the Billing System.

D. CONTRACTOR'S RISK ASSESSMENT

The auditor should develop a sufficient understanding of the risk assessment process currently employed by the contractor in terms of its identification, analysis, and management of risks relevant to the preparation of contract cost data and the generation of contract billings.

1. Meet with responsible personnel to obtain an overview of the various risk factors considered by management.
2. Once the various risk factors are identified, obtain an understanding of how management identifies the risks, estimates the significance of risks, assesses the likelihood of their occurrence, and relates them to contract reporting.
3. If applicable, obtain an overview of any plans, programs, or actions management may initiate to address specific risks. Keep in mind that, depending on the nature of specific risks, management may elect to accept a given risk due to costs or other considerations.
4. Document your overall understanding of the contractor's risk assessment practices.

E. INFORMATION AND COMMUNICATIONS

Information and communication processes consist of the methods and records established to record, process, summarize, and report contract cost data. The auditor should develop a sufficient understanding of the contractor's information and communication processes (relevant to contract cost data) to identify the significant classes of transactions and how they are initiated, processed, controlled, and reported.

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1. Since the accounting and EDP systems are integral components of information and communication processes, obtain a copy of the most recently completed Internal Control Audit Planning Summaries for the Environment and Overall Accounting Controls and the EDP System General Internal Controls. Review the rationale behind any moderate or high risk assessment ratings and determine the potential impact, if any, on the effectiveness of the Billing System internal controls. Document your evaluation.				
2. Review relevant permanent files, prior audit working papers, and any prior contractor demonstrations of its Billing System information and communication processes. Document your evaluation.				
3. Determine if the contractor has made changes to the information and communication processes in its Billing System since the last demonstration. Evaluate the changes. If no prior systems demonstration was performed, have the contractor provide one. Contractor representatives providing the demonstration should possess a detailed knowledge of the Billing System. The demonstration provides the auditor an opportunity to query contractor personnel regarding internal controls and how they are monitored. The auditor should ensure that the demonstration addresses the internal control objectives in section G. of this audit program.				
4. The contractor should include appropriate manual and computerized controls in its information processing that check for accuracy, completeness, and proper authorization of billing related transactions.				

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a. Have the contractor identify and demonstrate all access controls to the Billing System application and related transactions.				
(1) Compare the contractor disclosed access controls with the generic access control listing contained in CAM 5-1406.1 and identify access controls not incorporated in the application.				
(2) Verify the existence and adequacy of the contractor disclosed access controls. Discuss any apparent deficiencies with the contractor.				
b. Have the contractor identify and demonstrate all data input controls to the Billing System application and related transactions for originating, authorizing, collecting, preparing, and approving input transactions.				
(1) Compare the contractor disclosed data input controls with the generic input control listing contained in CAM 5-1406.2 and identify input controls not incorporated in the application.				
(2) Verify the existence and adequacy of the contractor disclosed input controls. Discuss any apparent deficiencies with the contractor.				
c. Have the contractor identify and demonstrate all processing controls for the Billing System, which ensure all authorized transactions are processed accurately and properly.				
(1) Compare the contractor disclosed processing controls with the generic processing control listing contained in CAM 5-1406.3 and identify controls not incorporated in the application.				

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(2) Verify the existence and adequacy of the contractor disclosed processing controls. Discuss any apparent deficiencies with the contractor.				
d.	Have the contractor identify and demonstrate controls related to the identification, correction, and resubmission of rejected data.			
(1) Compare the contractor disclosed error detection and correction controls with the generic error detection and correction control listing contained in CAM 5-1406.4 and identify controls not incorporated in the application.				
(2) Verify the existence and adequacy of the contractor disclosed error detection and correction controls. Discuss any apparent deficiencies with the contractor.				
e.	Have the contractor identify and demonstrate controls related to ensuring the output accuracy of computer program processing.			
(1) Compare the contractor disclosed output controls with the generic output control listing contained in CAM 5-1406.5 and identify controls not incorporated in the application.				
(2) Verify the existence and adequacy of the contractor disclosed output controls. Discuss any apparent deficiencies with the contractor.				
5.	Selectively trace billed amounts through the Billing System to validate your understanding of the information and communication			

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processes in the Billing System. Any discrepancies between your understanding and the contractor's demonstration should be noted and resolved prior to completing the remainder of this examination (see CAM C-306, Transaction Auditing, for additional guidance).

6. Document your confirmed understanding of the contractor's Billing System information and communication processes and obtain a written confirmation from the contractor indicating that they agree with this understanding. This documentation will typically take the form of system flowcharts or narrative descriptions and can be prepared by the auditor or consist of documentation prepared by the contractor (see CAM 5-106).

F. MONITORING

Monitoring is a process that assesses the quality of internal control performance over time. It involves assessing the design and operation of controls on a timely basis and taking necessary corrective actions. The auditor should develop a sufficient understanding of the contractor's ongoing monitoring activities, and/or separate evaluations related to the Billing System internal controls.

1. Determine if ongoing monitoring procedures are incorporated into the normal recurring activities of the contractor's organization. These procedures should include regular management and supervisory activities.
2. Where applicable, determine the extent of internal audit involvement in performing monitoring functions through separate evaluations.

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3. Determine and document the extent of monitoring activities being performed by external parties.				
4. Document your overall understanding of the monitoring activity being performed at the contractor's location and determine the impact it will have on our examination of the Billing System.				

G. CONTROL OBJECTIVES AND ACTIVITIES

The auditor should obtain an understanding of the contractor's control activities (policies and procedures) for each relevant Billing System control objective. A detailed understanding of control activities is essential to the assessment of control risk for each objective. Billing system primary control objectives and examples of control activities, as they relate to U.S. Government contracts, are provided in Attachment 1 (ICM-BILL). The audit procedures in this section, organized by control objective, are also included in the attachment.

The auditor should evaluate contractor internal and/or external audits to determine if any control activities have already been evaluated and if reliance can be placed on such evaluations.

The auditor should recognize those aspects of the contractor's Billing System that are automated and should ensure that the related control activities adequately address this automation by performing the audit procedures in section E above as well as those set forth below.

In performing the following audit procedures to understand the contractor's control activities, the auditor should recognize that while obtaining an understanding of the other components of internal control (control environment, contractor risk assessment, information and communications, and

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monitoring), he/she is likely to have obtained some level of knowledge about control activities. The auditor should utilize this knowledge in determining the additional time needed to obtain a sufficient understanding of the contractor's control activities.

1. Management Reviews

The contractor should have policies and procedures for monitoring of the billing process, including regular compliance reviews to ensure that billing requests are in accordance with applicable regulations, contract provisions, and related contractor policies and procedures. This must include periodic reconciliations of contract costs, as identified by the accounting system to costs billed.

Identify and selectively evaluate documentary evidence and the frequency of the contractor's management reviews and reconciliations of booked to billed costs to determine whether the scope of such reviews are appropriate, the conclusions sound, and appropriate follow-up actions were taken (See CAM 4-1000).

2. Policies and Procedures

The contractor should provide adequate written policies and procedures and training on the preparation and submission of billing requests in accordance with applicable regulations and contract provisions.

Review the contractor's written policies and procedures and assess their adequacy in the following areas:

- a. Training of employees involved in the preparation of billing requests. Verify that policies, procedures, and course materials are adjusted to comply with revisions to government rules and regulations.

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b. Briefing of contracts to identify and document billing requirements, including all contract modifications, and update of the briefs accordingly.				
c. Management review of billings prior to submission.				
d. Reviewing of subcontractors' accounting and Billing Systems to determine the systems are adequate prior to providing the subcontractors with interim financing.				
e. Reconciliation of Billing System data and records to the cost accounting records. If applicable, ensure that practices used to accumulate and bill costs are consistent with practices used to estimate contract costs (CAS 401 and FAR 31.201-1 and 31.203(d)) and that costs accumulated and billed are allowable in accordance with FAR 31.201-2.				
f. Adjustment of billings to reflect appropriate year-end and final indirect rates and direct costs including a review of subcontractors' billings to determine if they are also making year-end billing rate adjustments.				
g. Exclusion of the following unpaid items from billings:				
(1) accrued costs of direct materials and subcontract costs that the contractor (i) did not pay in accordance with the terms and conditions of the subcontract or invoice and (ii) ordinarily will not pay prior to submission of the contractor's next payment request to the government.				
(2) accrued costs that the contractor is delinquent in paying in the ordinary course of business				
(3) accrued costs of pensions, post retirement benefits, and profit-sharing or employee stock-ownership plans that have not been paid at least				

quarterly (within 30 days after the end of the quarter)

- (4) costs of progress payments made to subcontractors on terms less favorable to the government than the progress payment clause contained in the prime contract. In cases where the costs of subcontract progress payments are included in billings to the U.S. Government, ensure that the contractor has procedures to protect against overpayment and losses. These procedures should include the monitoring of performance and expected profitability of the subcontractors and reducing or suspending subcontractor progress payments as necessary.
- h. Estimates of costs attributed to items delivered/invoiced.
- i. Notification to the government that adjustments of billings may be required for potential loss contracts for that portion of costs attributable to the loss.
- j. Title to assets whose costs are billed to the U.S. Government.
- k. Use of the most current estimate to complete to prepare the billing.
- l. All changes to the Billing System and related software are validated and briefed to the government prior to implementation.
- m. Maintenance of cumulative allowable cost records required for the accurate and timely preparation of interim and final vouchers.
- n. Comparisons of amounts received to amounts billed for each invoice and follow-up with the paying office if amounts differ. If amounts received are greater than amounts billed, the difference should be immediately returned to the paying office.

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o. Reduction of billed amounts on delivery invoices for previously received progress payments.				
p. Withholding of fixed fees for cost reimbursement and T&M/labor hour contracts in accordance with contract terms (See CAM 6-1006a (5) and (6)).				

3. Implementation of Policies and Procedures

Provide that policies and procedures are executed to assure only billable costs/prices/fees applicable to U.S. Government contracts are included in billings in accordance with applicable regulations and contract terms.

- a. Interview billing personnel to determine whether they are familiar with, have access to, and actually refer to the written policies and procedures.
- b. Selectively review evidence that employees responsible for preparing billing requests have been trained in applicable billing policies and procedures. For example, review training records, course materials, and attendance sheets; interview employees; etc.
- c. Selectively compare the contractor's contract briefings to the applicable contracts and billings to determine if the contracts were adequately briefed and that they reflect unique contract requirements in their billing.
- d. Selectively evaluate evidence that management reviewed and approved billings. For example, assess management approval signature, interview billing employees, etc.

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e. Selectively verify that the adequacy of subcontractors' accounting and Billing Systems are assessed prior to providing the subcontractors with interim financing.				
f. Test to determine if the policies and procedures are being followed by:				
(1) Observation of the billing process				
(2) Inspection of selected billing records and documentation				
g. Selectively review contractor reconciliations of Billing System data and records to the cost accounting records. If applicable, ensure that practices used to accumulate and bill costs are consistent with practices used to estimate contract costs (CAS 401 and FAR 31.201-1 and 31.203(d)) and that costs accumulated and billed are allowable in accordance with FAR 31.201-2.				
h. Selectively evaluate Billing System and related software changes to determine if they were validated and briefed to the government prior to implementation.				
i. Selectively review contractor comparisons of amounts received to amounts billed for each invoice and determine, when the amount differs, if appropriate notifications were made to the paying office (especially for overpayments). Determine if the paying office's requested actions were complied with.				
j. Selectively review delivery invoices and determine that the amounts billed are reduced for previously received progress payment amounts.				
k. Selectively review interim and final closing vouchers submitted by the contractor and				

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determine if the amounts billed are reconcilable to the cumulative allowable cost records used to prepare interim and final vouchers. Test for the following:

- (i) Cumulative amounts billed on interim vouchers do not exceed the total estimated ceiling costs on the contract and/or the current contract maximum funding levels.
- (ii) amounts claimed on final voucher reconcile to annual incurred cost audit;
- (iii) assist audits have been received on all significant subcontract costs prior to the closing of applicable contracts;
- (iv) subcontract assist audit costs results reconcile with claimed costs on the final voucher;
- (v) refunds, rebates, credits, or similar amounts have been received, if any, and accounted for in the final voucher.

H. ASSESSMENT OF CONTROL RISK

1. Considering all five components of internal control, assess control risk for each of the relevant control objectives identified in section G. For each of the objectives, summarize the characteristics, which support the assessed level of control risk and specifically identify any internal control weaknesses or system deficiencies.
2. Determine if the system is adequate to reasonably assure proper pricing, administration, and settlement of Government contracts in accordance with applicable laws and regulations.
3. Based on the assessments above, determine the impact on the scope of other audits.

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4. Update the Internal Control Audit Planning Summary (see CAM 3-305).				
5. Coordinate the results of audit with the supervisor. The supervisor and FAO manager should review and initial the ICAPS before the exit conference is performed. If it is determined that additional audit steps are needed, any additional planned audit effort should be accomplished as part of this examination or immediately thereafter. Any delays in completion of this audit effort should be documented and approved by management.				

I. SUMMARY AUDIT STEPS

1. Prepare a draft audit report in accordance with CAM 10-400.
2. Conduct an exit conference with the contractor in accordance with CAM 4-304.
3. Finalize the audit report incorporating the contractor's response and audit rejoinder.
4. If the contractor has Earned Value Management System (EVMS) criteria covered contracts, provide comments in the audit report on whether any findings are likely to impact the contractor's EVMS (10-1204.5b). Discuss findings and recommendations relating to the EVMS with the Contract Administration Office C/S Monitor prior to issuance of the report. Immediately evaluate the impact of these findings on specific EVMS covered contracts and provide the details in flash EVMS surveillance reports (11-209.2.e).
5. Update the permanent file in accordance with CAM 4-405.1b (MAAR #3).

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6. Contact customers who require excessive documentation with vouchers explaining:				
a. How contract provisions require contractors to submit excessive documentation.				
b. How DCAA's ongoing presence and system examinations at the contractor can satisfy any customer billing requirements.				
c. That DCAA would like an opportunity to explain our process and discuss whether it satisfies their needs.				
7. Closing actions should be performed in accordance with FAO procedures. These procedures may require either auditors or administrative personnel to perform various closing steps. Completion of these closing actions should be documented in the working papers and should include:				
a. If the audit report has been electronically transmitted to the customer, file the signed original report in the audit working paper package. Otherwise, file a copy of the signed report.				
b. Include a printed copy of the final draft audit report containing the supervisory auditor's initials and date on the top page, cross-referenced to the working papers, in the working paper package. The final draft report should include all substantive changes made to the original draft, with cross-referencing updated as necessary. It should differ from the final report only due to minor administrative changes (spelling, format, etc.) made during final processing.				
c. Include an electronic version of the acknowledgement letter in the audit working paper package.				

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d. Include hardcopy printouts of the Administrative and Audit Working Papers indexes, including the supplemental listing of electronic files, in the working paper package.				
e. Ensure all working paper files are "read only" and, if necessary, compressed for final storage. Generally, current Agency software should be used to automatically modify all electronic files for storage.				
f. Two complete sets of electronic working papers must be prepared. The "original" set should be stored in the working paper package. The "archive" set is to be stored separately from the working paper package on removable media such as CD-ROM or diskette. If there will be a short-term need to access the working papers, a third, or "working" set should be stored so as to be available for reference, generally on the LAN. This set should be deleted when no longer needed.				
g. Verify that electronic files stored on removable media are not corrupted and can be unarchived.				
h. Securely enclose the "original" set of electronic files in the working paper package.				

TOTAL HOURS